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U.S. District Court in Atlanta Rules against the SEC in an Insider Trading Case, Describing the SEC's Evidence as 'Overreaching' and 'Self-Serving'

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The U.S. **Securities and Exchange Commission (SEC)** lost an insider trading case last week in federal court in the Northern District of Georgia. SEC v. Ladislav "Larry" Schvacho, 1:12-cv-02557-WSD (N.D. Ga. 2013). The SEC alleged that Defendant, a retired engineer from Cisco, Larry Schvacho, who is a close friend of Larry Enterline, CEO of Comsys IT Partners, misappropriated non-public inside information and traded on this information from November 2009 through February 2010. The SEC sought disgorgement of $512,667 of the allegedly ill-gotten gains, along with civil monetary penalties and a permanent injunction enjoining Schvacho from further violating Sections 10(b) and 14(e) of the Exchange Act. Though an insider trading case brought under Rule 10b-5 may be premised on circumstantial evidence, the judge found the agency's reliance on purely circumstantial evidence unpersuasive. The Court also found the SEC had attempted to portray the circumstantial evidence in an "overreaching, self-serving" manner, and dismissed all claims. *Id*., at 40.

The chronology of facts in this case undoubtedly piqued the interest of the SEC Enforcement attorneys. Defendant Schvacho and Enterline have been close personal friends for nearly three decades, often seeing or speaking with each other 2-3 times per week. Schvacho retired in 2009 and began researching and trading stocks. He acquired and built a position in the shares of Comsys IT Partners, a then publicly traded company where Enterline served as the CEO. During four months in 2009 and 2010, Enterline was negotiating the acquisition of Comsys by Manpower, and Schvacho continued purchasing additional shares of Comsys. During that same time period, Schvacho and Enterline spoke almost daily, had dinner together in Atlanta, and travelled for a weekend on Enterline's boat. In early 2010, Comsys announced the acquisition publicly, and Schvacho sold half his position the day after the announcement. The share price had more than doubled since Schvacho first began accumulating Comsys shares in October 2009.

The SEC's Complaint alleged that during the operative 2009-10 four-month period, Schvacho was either given, or overheard, material non-public information about the possible acquisition of Comsys through his friend, Enterline. To support the insider trading claims, the SEC introduced dates and times of telephone calls and text messages, details of Schvacho and Enterline's dinner, and the boating trip from St. Petersburg to Ft. Myers. They also introduced the coinciding dates of Schvacho's purchases of Comsys stock, but did not present the content of any discussions, text

messages, or actual information that was exchanged or obtained by the Defendant Schvacho.

District Court Judge William R. Duffey, Jr. concluded that, while the SEC can present a case for misappropriation based on circumstantial evidence, it must prove "by a preponderance of the evidence that Schvacho owed Enterline a duty of confidentiality, and that Schvacho used inside information to trade Comsys shares." *Schvacho*, at 32. The frequent personal contact corresponding with trade dates as presented by the SEC alone was insufficient. "While the timing is interesting it is not persuasive and does not meet the SEC's burden of proof." *Id.*Judge Duffey refused to take the final conclusory jump the SEC had asked: to accept that because *the opportunity* to exchange information existed, the *actual exchange* of inside information had therefore taken place. "Potential 'access' [however] to material, nonpublic information, without more, is insufficient to prove [the defendant] actually possessed such information." *Id.*, at 33, *citing SEC v. Rorech*, 720 F. Supp.2d 367, 410 (S.D.N.Y 2010). Judge Duffey also took issue with the SEC's failure to present evidence to establish the content of the communication during those meetings or phone calls; and he suggested the failure to introduce the actual content of the text messages was telling since the text messages are usually available from service providers.

Ultimately, Judge Duffey found there was "not any evidence of the content of any communication between Enterline and Schvacho to support any communication of insider information — deliberately or carelessly . . . ." *Schvacho*, at 41. The circumstantial evidence that two longtime friends maintained a close friendship and communicated frequently during the four months leading up to the Comsys acquisition was nothing more than the SEC's hypothesis as to what *could* have happened . . . and this alone was insufficient to establish proof of violations of Rule 10b-5.

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